

BANKRUPTCY THROUGH OTHER MEANS: THE GOVERNMENT'S OVERREACTION TO 9/11

BY

COLONEL CHRISTOPHER D. LONG
United States Army

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USAWC STRATEGY RESEARCH PROJECT

**BANKRUPTCY THROUGH OTHER MEANS: THE GOVERNMENT'S
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Colonel Christopher D. Long
United States Army

Professor Frank L. Jones
Project Adviser

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U.S. Army War College
CARLISLE BARRACKS, PENNSYLVANIA 17013

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The 9/11 attack is one of two events in U.S. history that is unmatched in terms of its psychological impact and associated loss of life. Its aftermath is also unmatched in terms of the government's dramatic overreaction. This overreaction entailed costly governmental reorganization, mobilization for war, and relaxed lending standards designed to spur an economy that fundamentally did not need such intervention. Additionally, the government borrowed from entitlement programs to fund the national response to terrorism. Years of deficit spending, a public debt that has doubled in the last five years, and rapidly depleted retirement and entitlement accounts have been the unfortunate result. While the future impact of such an approach on the individual taxpayer will be dramatic, it pales in comparison to the economic costs involved in maintaining the national power of the world's most indebted nation, the United States. This paper explores the consequences of the Bush administration stance toward fighting the "Long War" and offers proposals as to what the next administration should do to prevent long-term strategic harm to the nation.

BANKRUPTCY THROUGH OTHER MEANS: THE GOVERNMENT'S OVERREACTION TO 9/11

We bled Russia until it went bankrupt and withdrew in defeat...so we are continuing this policy in bleeding America to the point of bankruptcy.

—Osama bin Laden, 2004¹

The terrorist attacks on September 11, 2001 far exceeded Osama bin Laden's wildest expectations for tactical success in New York City and Washington, D.C. He had no way of knowing on that fateful day what America's response or series of responses would be. Further, he did not know whether or not his attacks would hold long-term strategic value. However, just three years removed from 9/11 and \$346 billion in U.S. spending later, bin Laden knew with absolute clarity he and the Al Qaeda network had spurred the American government into costly actions to protect its homeland and even more costly actions in a long war it had no hope of financially sustaining. In short, Bin Laden watches today from his cave while America continues its disproportionate overreaction to a single attack.²

This is not an anti-war paper. The reasons for going to war were sufficiently justified at the time, even if the enemy (terrorism) is not definable and remains so today. It does not question the operational rationale for going to war in Afghanistan and Iraq, as it is clear that states supporting terrorism must be aggressively and decisively dealt with. Abstract enemy forces aside, America's homeland was attacked, the country went to war, and America will find ways to "win" as soon as conditions for an achievable and tangible victory are ultimately defined. After the expenditure of over \$1.2 trillion dollars and counting, the United States and its strategic leadership position as the world's remaining superpower cannot afford anything less.³

This paper is, however, about the costs of the decisions made to mobilize for war. It is a declaration that America's collective response to the attacks of 9/11 was a dramatic *overreaction*, especially when put in historical and statistical context. This declaration is hardly novel, given the number of researchers with the same opinion. However, the distinguishing concept supporting the overreaction position taken in this paper goes past the how and why dollars were spent, and highlights the ultimate effect those expenditures will have on America's center of gravity—the will of the American people to keep fighting. Simply stated, the American people will tire of the “Long War” for economic reasons long before they grow weary for other causes.

This paper defends the argument that the health of the economy invariably affects the nation's center of gravity by presenting specific examples of how governmental overreaction undermines this health. I will define the cumulative costs associated with the government's approach to the War on Terror, compare those costs to past conflicts, and present the fiscal effects the overreaction will have on the American people and America's economic position overseas. Finally, the paper offers recommendations for refocused, more efficient, and more economic counter-terrorism and homeland defense efforts in the years ahead.

We Were Warned

In his farewell address on the night of January 17, 1961, President Dwight D. Eisenhower warned the American people against the dangers of what he called, “the military-industrial complex.” The lens he used to orient his astute observations was clearly focused on the Cold War—and specifically the government's reaction to the spread of communism. Legitimate fear of nuclear holocaust aside, his comments and

his desire to make them on his way out of office exposed his own remorse for leading a self-perpetuating, bureaucratic escalation of the arms race and a collective overreaction to fear that communism offered a clear and present danger to the United States. Fast forward forty years and substitute the context of “communism” with the modern-day concept of “terrorism” and Eisenhower’s admonition against reckless, expensive overreaction remains as relevant now as it was then:

As we peer into society's future, we—you and I, and our government—must avoid the impulse to live only for today, plundering, for our own ease and convenience, the precious resources of tomorrow. We cannot mortgage the material assets of our grandchildren without risking the loss also of their political and spiritual heritage. We want democracy to survive for all generations to come, not to become the insolvent phantom of tomorrow.⁴

The Road to War

In the immediate aftermath of the 9/11 attacks, President George W. Bush had myriad responses to choose from. However, hasty analysis essentially produced two choices. The nation could assume a war-like posture, creating new command infrastructures and new policies and procedures to administer them, or it could work to fix homeland security and intelligence processes that were obviously ineffective. After the highly controversial election of 2000 and the legal fight against former Vice President Albert Gore to ultimately assume office, President Bush was under tremendous pressure for quick, decisive leadership in his response. This pressure to act caused him and his advisors to disregard historically established Al Qaeda tactics, techniques, and procedures relating to conduct and duration between attacks. Instead, the Bush Administration picked option one: go to war.

Was going to war, or at least spending money to support a two-theater war and the biggest governmental reorganization since 1949, warranted in 2001? As illustrated

by the following table, Al Qaeda's mode of operation in the years prior to 9/11 was isolated to deadly single attacks spread over significant periods of time.

Date	Event	Time Since Last Attack
26 Feb 1993	World Trade Center Bombing	N/A
25 Jun 1996	Khobar Towers Bombing	3 years, 3 months, 30 days
7 Aug 1998	East Africa Embassy Bombings	2 years, 1 month, 13 days
12 Oct 2000	Attack on the USS Cole	2 years, 2 months, 5 days
11 Sep 2001	Attacks on WTC and Pentagon	10 months, 30 days

Figure 1: Timeline of Al Qaeda Attacks⁵

Was America truly at war, or had American interests simply been attacked again? If America was at war, why didn't it mobilize and join the battle against terrorism when Osama Bin Laden and Al Qaeda declared war on the United States in the fatwa they voiced in 1996?⁶

With the media regarding the attack as the modern-day Pearl Harbor and the harbinger of more terrorism to come, the casual civilian observer accepted the collective attitude that the 9/11 attack was simply too bold and destructive for America to tolerate; and the government's reaction—regardless of what it was going to cost—was acceptable if Americans felt safe. This same casual civilian observer did not have the benefit of access to intelligence gathered before and immediately after the attack, so he also assumed the government was acting in his best long-term interests. After years of war against other intangible forces such as “drugs,” going to war against “terrorism” seemed reasonable to most citizens, and the President got the mandate he needed to go on the offensive overseas and to reorganize the government.

Examples of the Overreaction

The over-reaction to the attack began immediately after 9/11, obviously fueled by fear and outrage. For example, the United States Postal Service's response to the anthrax attacks after 9/11 cost the taxpayers \$5 billion, or \$1 billion for each American killed in the attacks.⁷ In hindsight, this anthrax attack was likely conducted by a disgruntled government employee and not Al Qaeda, but the fear that dominated the government's thinking in the days after 9/11 justified this massive response. Additional examples of governmental overreaction exist, with the most notable example being the establishment of the Department of Homeland Security and its meteoric rise as a competitor for national resources. There are also numerous examples of costly unintended consequences associated with governmental action, including lost wages and lost intellectual capital investment in the form of bright young students from other countries—students that historically become American citizens and contributors to the economy. A discussion of each of these examples is warranted.

Establishment of the Inefficient Department of Homeland Security. With smoke still rising from the ruins of the World Trade Center, President Bush secured \$40 billion in emergency funding and created the Office of Homeland Security (OHS). Led by former Pennsylvania Governor Tom Ridge, the OHS began work to develop a strategy to secure the homeland from future threats. As this strategy developed, it became clear that evolutionary change to existing homeland security processes might fix what was broken. However, analysis of the terrorist threat promulgated by the government and hyped by the media promoted revolutionary change which was justified in order to stay prepared for potential terrorist threats. Thus, President Bush made his proposal for these changes through creation of a new cabinet-level department. Congress affirmed

the proposal, and President Bush signed the Homeland Security Act of 2002 into law on November 25, 2002, creating the Department of Homeland Security (DHS).⁸

DHS' simplified mission statement is to prevent terrorist attacks within the United States and to reduce the country's vulnerability to terrorism at large. Additionally, it is to minimize damage and to assist in recovery from attacks that could occur. It is to carry out all the functions of the disparate agencies that make up its ranks and to act as a focal point for response to natural and man-made disasters. Finally, it is to make sure processes carried out by its subordinate agencies not directly related to homeland security are not marginalized; and to monitor the connection between illegal drug trafficking and terrorism.⁹

In the first two years of its existence, DHS' budget grew 60 percent to \$36.2 billion. During that same period, 61,000 additional government employees were added to its rolls, bringing the total working for the department to 113,000. In addition, the DHS had under its direct control over 250 airplanes and helicopters and more than 280 boats.¹⁰ The public thought America was ready for anything. The American people could not have been more wrong, and they were about to get a dramatic, non-terrorist reason why.

September 2005 brought DHS its first real test in Hurricane Katrina, and it failed miserably. Forecasters knew for over a week prior to the disaster the storm was moving to the Gulf Coast and they knew five days before landfall it would reach landfall in the vicinity of New Orleans. Regardless, the actual pin-point location of the disaster should have been largely irrelevant to an organization as well-funded and as supposedly capable as DHS. After the storm passed, DHS failed to lead in the face of chaos—the

very reason it was formed and funded. Ironically, one of the only examples of capable and coherent leadership shown in the aftermath of the storm was personified by the Army's straight-talking Lieutenant General Russell Honoré, who took charge of day-to-day relief operations and saved DHS from additional embarrassment.

In the fiscal year prior to Katrina, DHS received \$3.2 billion for disaster relief operations, including a \$300 million pre-disaster mitigation program, because, in the Office of Management and Budget's explanation, "experience has shown that the devastation caused by disasters can be minimized through a well-designed mitigation program."¹¹ Regardless, Hurricane Katrina proved to be an unfortunate test of DHS' ability to provide a coherent national-level response to a threat to the homeland. It served as an unfortunate exemplar of reckless post-9/11 government spending with associated inefficiency. The White House's own report on the disaster states, "...whatever improvements have been made to our capacity to respond to natural or man-made disasters, four and half years after 9/11, we are still not fully prepared."¹² Katrina should have led to a larger examination of whether or not DHS was ever going to be prepared for another 9/11-like event, but it did not, and DHS marched on essentially unchanged, receiving another \$169 billion dollars in funding since the disaster.¹³

Terrorism continues to exist, and the creation of DHS as a counter-terrorism entity orchestrating the efforts of 22 previously existing government agencies was regarded as a prudent measure, given the exposure of past intelligence and command and control problems between those same agencies in times of crisis. However, the degree, scope, and climate of inefficiency within DHS remains problematic. Some

experts believe DHS is already in need of reorganization, restructuring, and release of some of its subordinate agencies back to pre-9/11 position and/or status.¹⁴ After inception, DHS did a poor job of preparing itself for consequence management with the lessons of 9/11; it was slow to react to lessons learned from Katrina, and is not managed in response to real statistical threats. As the table introduced earlier shows, Al Qaeda's general mode of operation is to wait years between significant attacks. Statistically, the probability of dying in an 80-year lifetime at the hands of a terrorist (including the ongoing fights in Iraq and Afghanistan) is 1 in 80,000, or about the same likelihood that one would die from an impact of an asteroid or comet on the planet Earth.¹⁵ Does that 1-in-80,000 probability justify a budget that has steadily increased over the last six years and is now 237% higher than it was in 2001?¹⁶ More importantly, does DHS' demonstrated counter-terrorism efficiency since its inception warrant this level of funding? Clearly, it does not. Facts related to DHS' seemingly inefficient role in counter-terrorism follow:

- Despite repeated warnings of Al Qaeda "sleeper cells" capable of spectacular attacks hiding in the continental United States, no such sleeper cell has ever been taken into custody.¹⁷
- Despite "credible" intelligence of a 2002 plot to hijack an airliner, use a shoe bomb to blast a path to the cockpit, and then fly the plane into a building in Los Angeles, no one has ever been charged or taken into custody.¹⁸
- Despite receiving \$52 billion since its formation for security of the nation's borders, DHS has failed to stop the illegal movement of over 1200 persons a day, or over 400,000 persons a year, into the United States¹⁹²⁰

- Thousands of people have been under surveillance of federal intelligence and law enforcement agencies under the provisions set forth by the PATRIOT Act. Through 2006, less than 10 people a year have justified warrants for more in-depth surveillance and none have been formally charged of wrong-doing.²¹

The Unintended Consequences. The Department of Homeland Security infrastructure is merely an expensive example of the overall cost of overreaction to the 9/11 attack. There are many other direct and indirect costs that continue to add up. For example, one economist calculates that rules requiring people to spend an additional half-hour in airports for security screening costs the economy \$15 billion a year—funds that would otherwise be contributing to the gross domestic product and generating revenue for the country's continued solvency. In comparison, total airline profits in the deregulated, ultra-competitive years before 9/11 never exceeded \$5.5 billion a year. In other words, the nation is losing three times more money standing in line at the airport each year than all the profit the airlines collectively made in their best year combined.²²

Restrictions placed on entrance visas have severely hampered scientists, engineers, and businesspeople vital to the American economy from travel into the United States; restrictions that will no-doubt have a lasting effect on long-term economic growth. Universities are feeling the same effect of these travel restrictions, with a 21% reduction in graduate student applications—exactly the same percentage drop as the reduction in overseas student visa applications. The country has historically relied on these foreign students, many of which ultimately choose to remain in the United States, request citizenship, and make lasting contributions to the economy.²³

Expensive Defensive Focus. By 2003, a list of over 33,000 potential “soft” targets for terrorism was provided to DHS Secretary Tom Ridge. Presumably, this list was designed to give the secretary a means needed to prioritize resources in order to bolster a better defensive posture at those locations. Within a year, this list grew to over 80,000 locations. Were those additional 47,000 sites suddenly more vulnerable than they were a year earlier? Obviously they were not. The inclusion of those new locations came after state and local officials started learning of creative and completely irrational federal spending such as \$180,000 for a port that receives fewer than 20 ships a year, \$30,000 for a defibrillator bought for a high school basketball tournament, and \$545,000 to fund rescue and communications equipment for a 1500-person town in Alaska. As a result of this fiscal irresponsibility, a 2006 congressional report identified over \$34 billion in overcharges, wasteful spending, or mismanagement at DHS.²⁴ When put into perspective, this amount is nearly equivalent to DHS’ budget for an entire fiscal year. Said another way, the government admits DHS has wasted 17% of its funding since it was established in 2002.

Going to War Overseas—The Overreaction Continues

Post-script assessment that mobilization and deployment for war were an overreaction to attacks on the homeland is counter-intuitive and is not this paper’s position. Again, this is not an anti-war paper—it is a study of the costs associated with America’s response to the 9/11 attacks and their long-term impact. The reasons for going to war in 2001 and pursuing regime change in Iraq in 2003 were, using the evidence of the day, fully justifiable against any acceptable standard. However, rushing to declare war against terrorism, an abstract concept oriented on tactics used by radical

Islamic fundamentalists and anyone else using fear to further their goals, and failing to clearly define tangible conditions for victory and its associated costs are completely reasonable subjects for scrutiny.

The background: Al Qaeda attacked the United States from a base of operation was in Afghanistan, and the Taliban controlled Afghanistan in 2001. The Taliban sponsored Al Qaeda training camps in Afghanistan and was therefore complicit in the 9/11 attacks by “aiding and abetting murder.”²⁵ In regard to Iraq, intelligence analysts, some of the same analysts that incorrectly assessed numerous Al Qaeda sleeper cells were operating in America, incorrectly assessed weapons of mass destruction were being stockpiled in Iraq. These incorrect assessments led to the decision to pursue regime change in Iraq. Regardless of the causes used to anchor justification for deployment, decisions were made to go to on the offensive, and America went to war.

Operations in late 2001 to rid Afghanistan of the Taliban regime, to attack Al Qaeda in its safe haven, and to immediately end the terrorist careers of over 70% of the Al Qaeda membership were effective, efficient, and decisive. Major combat operations in Iraq were equally decisive, successfully removing Saddam Hussein from power and setting the conditions for democracy. Al Qaeda in Iraq is largely defeated, and a surge of troops at the right time and places averted civil war. In 2008, violence is dramatically decreased and the Iraqi people are taking an ever-increasing role in their own destiny.

These successes aside, there remain some undeniable facts and unanswered questions: Al Qaeda is not completely defeated, and “winning the peace” in Iraq remains elusive and expensive. A troop surge in Afghanistan along the same magnitude as the surge used successfully in Iraq is planned. With an occupation force

in Iraq for the foreseeable future and a surge of personnel required to continue the fight in Afghanistan, what are the desired endstates? What defines success? What set of physical conditions must exist before the nation declares victory and returns to a more defensive, and significantly less expensive, posture at home? To be clear, going to war in response to the 9/11 attacks against a targetable enemy was not an overreaction. Rushing to war against a concept or tactic (terrorism) without a plan for tangible victory and attainable goals was an overreaction, and it is costing the American taxpayers significantly more than the \$1.2 trillion already spent on the conflict at home and abroad. In order to appreciate the total financial impact of this overreaction, a discussion of the costs associated with the kinetic fight overseas and their long-term impact is warranted.

The Cost of War—2001 to 2008

In the seven years since the 9/11 attacks, the United States has provided \$859 billion to the Department of Defense for conduct of the war on terror. Obviously, the majority share of the DoD's resources have been utilized in Iraq, with \$653 billion spent thus far. Spending for Operation Iraqi Freedom began in Fiscal Year 2003 and has steadily increased an average of 19% each year. Spending increased 31% in 2004 as American forces began to grapple with the developing insurgency, and increased another 24% between fiscal years 2006 and 2007 with the surge of forces required to reduce the threat of civil war.²⁶ Figure 2 depicts the distribution of this funding.

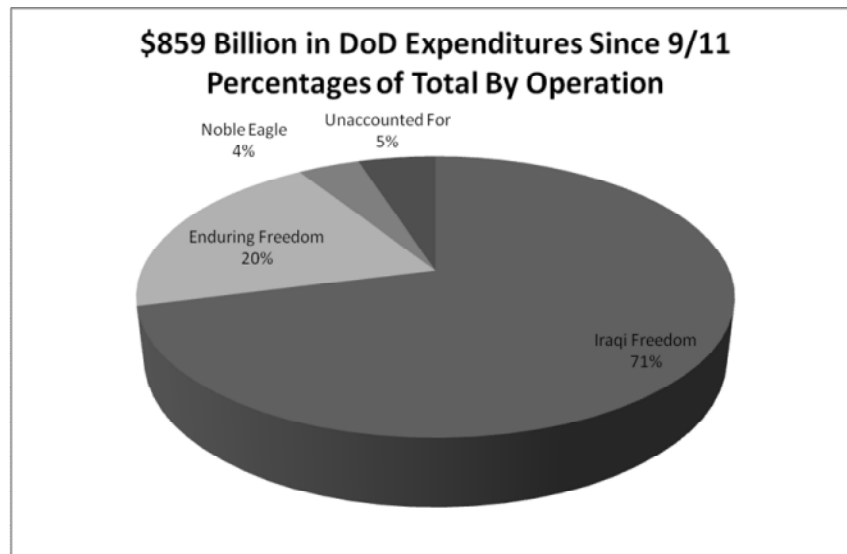


Figure 2: Total Wartime Funding

Spending in Afghanistan in support of Operation Enduring Freedom has remained relatively constant, with a total of \$172 billion spent since 2001. When combat operations in Iraq became the focus of main effort, spending in Afghanistan dropped 30% in fiscal year 2003 and dropped another 2% in fiscal year 2004. When the situation in Iraq began to stabilize, the war in Afghanistan received renewed emphasis, and spending jumped an average of 27% a year in each of the three fiscal years between 2005 and 2007.

The authorization to mobilize thousands of National Guardsmen and Reservists to active duty, to fly air patrols over the Continental United States, and to complete the numerous physical security enhancements needed on all military and government installations is collectively called Operation Noble Eagle. Noble Eagle accounts for \$28 billion of the total cost of the war, with \$21 billion of that total spent in the two year period immediately following the 9/11 attacks.²⁷ As the distribution of funds depicted in

Figure 2 shows, neither the Congressional Research Service, nor the Department of Defense can account for over \$5 billion spent in fiscal year 2003.²⁸

It is important to note that wartime spending doubled between 2002 and 2003 and increased another 75% between 2004 and 2007. This year's defense budget represents a 160% increase from 2004 levels. Finally, over 90%—or more than \$773 billion spent thus far has been provided to DoD as emergency funds in supplemental or additional appropriations over and above amounts provided in regular defense bills.²⁹

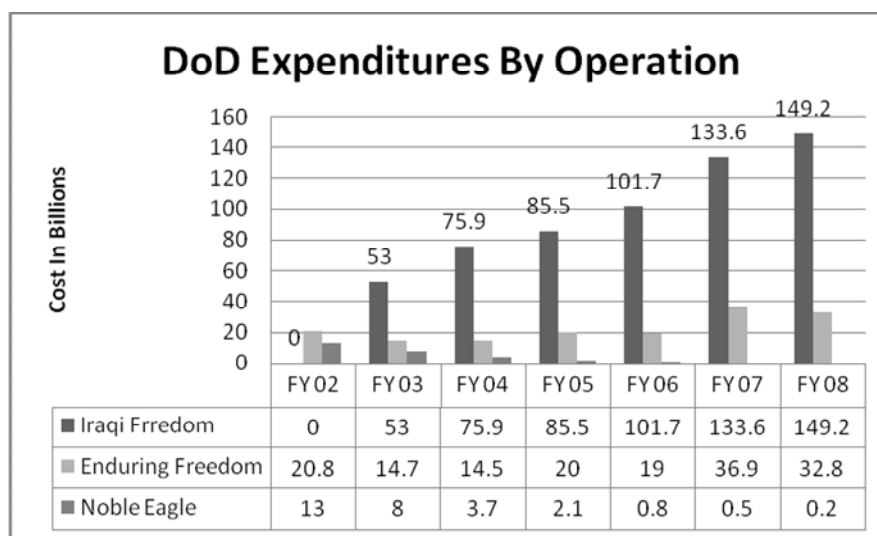


Figure 3: Wartime Expenditures by Year

Projected Cost of War—2008 to 2018

Both candidates in the 2008 presidential election campaign vowed to begin a drawdown of troop levels in Iraq and Afghanistan, but both are quick to relate their potential troop reductions are tied to security conditions on the ground and not to specific benchmark dates for departure. As a result, fiscal planners have generated two basic scenarios in order to forecast costs. Understandably, one plan is very liberal in its planned execution, and one is very conservative. The liberal plan envisions troop levels

in Afghanistan and Iraq dropping to 30,000 by 2010 and the conservative plan envisions troop levels dropping to 75,000 by 2013.

Called the “low alternate path,” the aggressive plan predicts future spending of \$570 billion through 2017. The “high alternate path” predicts \$1.05 trillion in future wartime spending. When added to funding already appropriated by Congress for the same timeframe, the costs are \$1.2 trillion and \$1.7 trillion respectively.³⁰

The following graphs depict projected spending in each scenario, by year.

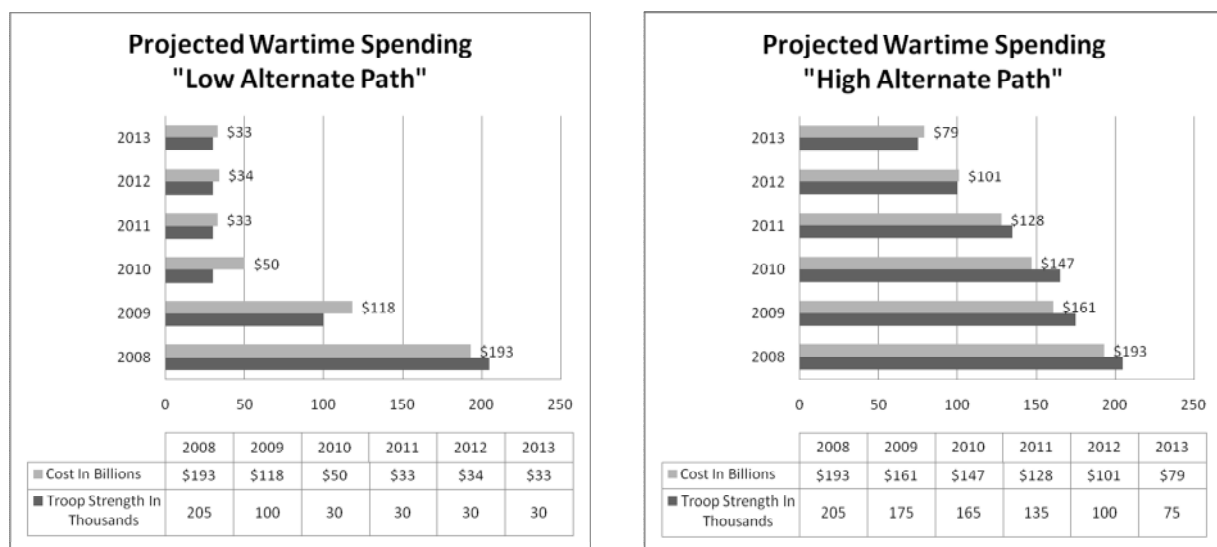


Figure 4: Comparison between Projected Spending Plans

The Pentagon must also plan for maintaining a long-term occupation presence in Iraq. Called the “Korea Option,” this plan features an assumption that 55,000 personnel would be required to meet all stability and support requirements. Costs for this occupation force are projected to be \$10 billion a year in a permissive, non-combat role; and \$25 billion a year for prolonged combat operations.³¹

Cost Comparison with Past Conflicts

The total cost of the war on terrorism is largely incalculable. There is simply no way to capture second and third-order effects of decisions made accurately, or for lost revenues because of changes in behavior. The argument set forth in this paper is anchored to the clearly documented \$1.2 trillion spent by the federal government on DHS and DoD efforts. However, estimated state and local government spending pushes the overall total to over \$3 trillion dollars.³²

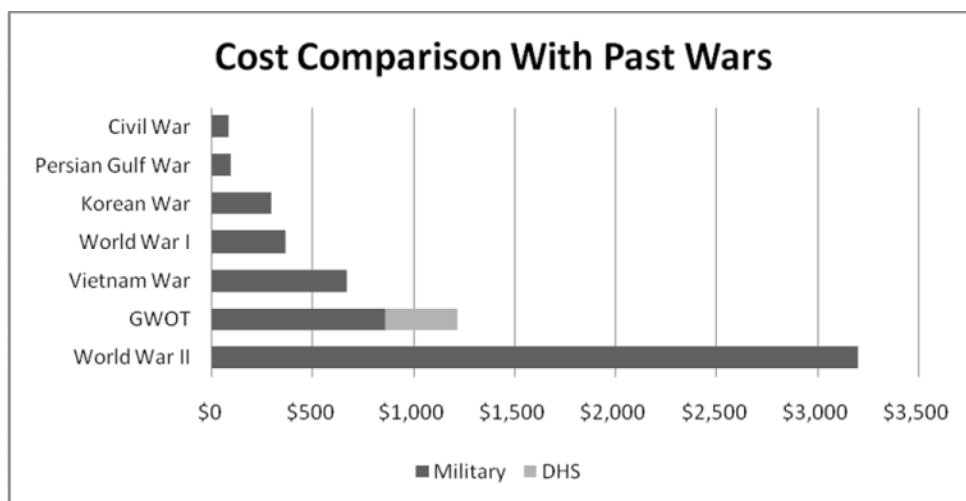


Figure 5: Costs of Military Operations since the Civil War

It is common knowledge the government is borrowing money to pay for military operations. However, what is not widely known is that interest payments on the money borrowed thus far could add another \$615 billion to the running total. The military component of the War on Terror is already twice as expensive as the Korean War, and a third more expensive than the Vietnam War, which lasted 12 years. Current estimations put the cost of the war in Iraq alone at 10 times more costly than the Gulf War and twice as costly as all American involvement in World War I. Only World War II has been more expensive.

However, the cost of the war on terrorism will not end with the cessation of hostilities between armed combatants. It is estimated over \$590 billion will be spent on future disability and health care benefits for the war's veterans. Additionally, over \$280 billion is projected to be spent on replacing or restoring military equipment to pre-war readiness.³³ Finally, economists estimate that at least 10% of the price of a barrel of oil is the "terrorism tax" being paid in response to the collective market's fear of decreased supply caused by war in the Middle East.³⁴ It is estimated this "tax" has cost over \$274 billion in increased oil prices so far.³⁵

Debits Versus Credits—The Impact of Counterintuitive Processes

Despite significant, and in most cases misguided, concerns in the aftermath of the 9/11 attacks, the long-term health of the US economy was not adversely affected by the attack itself and has shown remarkable resilience in the face of wartime adversity. The US economy grew at a rate of 1% in 2001, rising to the pre-9/11 level of 3% in 2003 and 4% in 2004.³⁶ However, efforts to keep the economy out of recession have backfired, as evidenced by the recent need for Congress to authorize over \$700 billion to rescue Wall Street lending institutions and the related securitized home mortgages they administer.

The following independent actions have become interdependent over time and together formed the "perfect storm" against the US economy:

- As a candidate for president, George Bush promised to lower taxes and return part of the existing \$159 billion budget surplus back to the taxpayers. He implemented the first phase of tax reductions in 2001, prior to the 9/11 attack.

- President Bush implemented the second round of tax cuts in 2003. His logic, especially after the 9/11 attacks, was to spur economic growth through increased consumer spending. In short, he believed lower taxes and more disposable income would equate to more consumer spending.
- At the same time, lending institutions were lowering interest rates on home loans and enticing new borrowers into the market through low, adjustable rate mortgages.
- Oil prices increased an average of 17% a year after the 9/11 attacks and subsequent military action in Afghanistan and Iraq.³⁷

Each of these points warrants emphasis and an explanation of their interdependence.

First, Congress approved President Bush's 2001 tax cut in the midst of a recession, which worsened in the immediate aftermath of the attack. The recession was mild, but the recovery from it was slow and was hampered by increasing unemployment rates. Productivity eventually improved and as evidenced by growth data, the economy recovered. However, the national budget surplus was depleted nearly immediately after the first round of tax cuts and the nation posted a huge trade deficit.³⁸

Second, the Bush Administration's counterintuitive 2003 tax cut enacted after mobilization for war, the largest reorganization of the government in 50 years, and a huge new prescription drug benefit for Medicare recipients drove the budget deficit to record levels just three years removed from a \$159 billion surplus.³⁹

Third, after the technological bubble of the late 1990s burst in early 2000 and the subsequent recession that followed the 9/11 attacks, lenders—led by the Federal

Reserve—did everything in their power to get the already-recovering economy moving in a more aggressively positive direction. Debt-to-income ratios were creatively adjusted to accommodate borrowers who had never previously qualified for home loans. For others, credit scores were increasingly less important for qualification. In other cases, borrowers opted for adjustable rate mortgages because of their attractively low interest rates; literally banking on the false impression the Federal Reserve would continue to keep interest rates low. For many, traditional 20% down payments were funded by home equity loans taken out by the borrowers by using their prospective homes as collateral. In effect, the borrowers had no real equity in their homes. These newly qualified homeowners were only marginally capable of affording their new homes and needed only a small change in disposable income to completely disrupt their lives.

That change in disposable income came by way of the fourth point: oil prices and rising interest rates. As stated above, the average increase in oil prices each year since the 9/11 attacks rose 17%. However, in 2004 and 2005, oil prices increased 22% and 31%, respectively.⁴⁰ With transportation costs, manufacturing costs, and food costs all inextricably tied to the price of a barrel of oil, the cost of *living* became more important than the cost of living in a house. As a result, many Americans are giving up their homes, walking away and letting their banks foreclose on their dreams. Now that the banks have reached the limit of the mortgage losses they can safely absorb, the government has stepped in with \$700 billion the nation has to borrow in order to save its troubled economy and to continue to show economic leadership overseas.

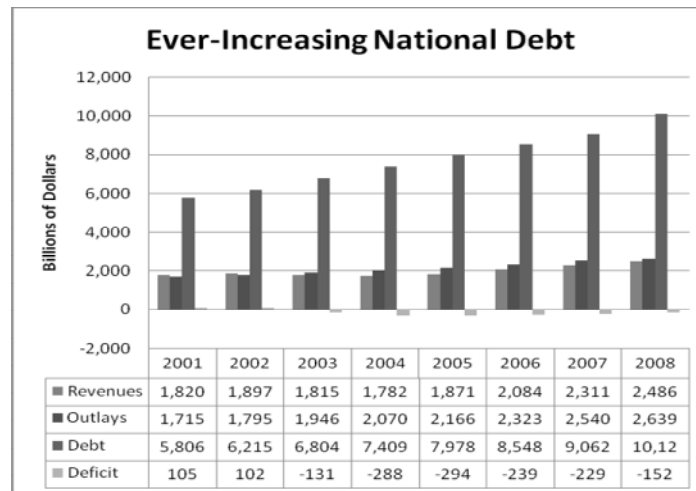


Figure 6: Revenues, Outlays, Debt and the Deficit

This economic catastrophe could have largely been avoided if the government had not overreacted and let history guide it in the conduct of the current war. The War on Terror is the first war in the nation's history that didn't include significant sacrifice from the American people. In fact, our existing income tax system was created by President Lincoln to fund the Civil War. Simply stated, the president declared war on terrorism, his constituents agreed with the declaration, the government was reorganized, and American forces went to war overseas. However, only the government and the military went to war; the American people were never asked to mobilize and contribute to the war effort. War bonds were not sold. Resources were not rationed or recycled. Taxes were not only reduced. Instead, taxpayers received rebates on top of their refunds as "stimulus" to spend more money. This was a tremendously important series of mistakes for a nation at war, especially given the self-perpetuating and expensive nature of the homeland security establishment and ongoing military operations overseas. Taken together, these circumstances have contributed to record spending deficits and over \$10 trillion in public debt.

The Long-Term Effects

America has carried a public debt since 1791 and has endured many wars, so it would be easy to ask why this period of history is more critical than any other.⁴¹ The answer lies in the ever-increasing speed the public debt is accruing, and the interest the government must pay for borrowing money. After the 9/11 attacks, the prevailing idea across America was to conduct business as usual. Anything short of Americans acting like Americans would be perceived by the rest of the world as an opening round victory for the terrorists. While this is true, the set of economic conditions previously outlined in this paper were designed to affect normalcy in the face of adversity, but they had unintended second and third order effects. These effects of overreaction seven years after the attacks of 9/11 dictate immediate governmental changes to current spending trends in order to preserve the American people's will to continue the fight against terrorism and to preserve the country's ability to use economics as an element of national power.

Effect on Will of the People. Individually, the American people will soon be brought into the war effort and will shoulder a much larger responsibility than they would have if they were involved earlier in the conflict. There is simply no way to continue the fight using today's financial model. Whether sweeping tax reform is immediate after the inauguration of a new president, or occurs in 2010 when the current tax legislation expires, the nation's 135 million taxpayers will soon bear an exponentially greater sacrifice than they would have borne years earlier.

The new president, if acting responsibly to recover America's economic position, can not avoid increasing taxes. This position is anchored on two major realities. First, the war is not yet won and military operations will continue overseas for the foreseeable

future. And second, wartime funds normally raised through taxation were borrowed from the nation's entitlement systems instead, and must soon be paid back or the systems will become insolvent.

The nation's entitlement systems are the Social Security Trust Fund, Medicare Trust Fund, Civil Service Retirement and Disability Trust Fund, Military Retirement Trust Fund, and various additional funds. The chart in Figure 7 depicts intergovernmental borrowing against these trust funds as percentages of the total. For the purposes of brevity, only the impact on the Social Security Trust Fund, the largest fund affected, will be outlined in this paper.

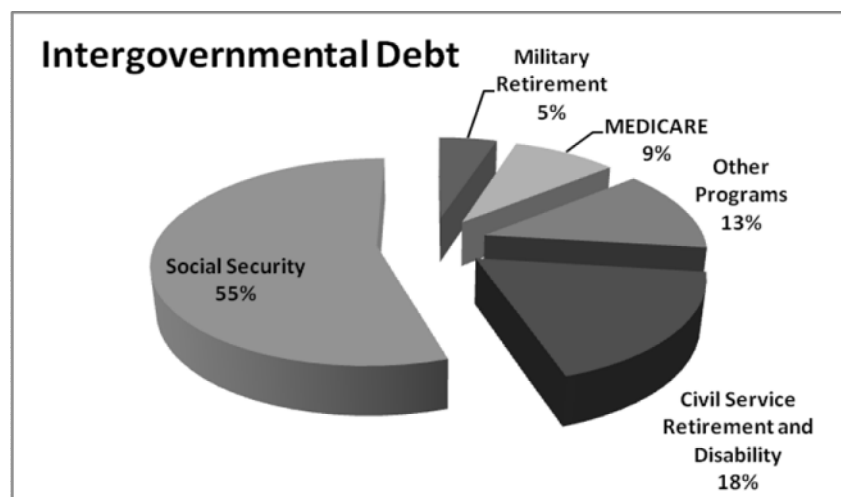


Figure 7: Government Borrowing From Entitlement Programs⁴²

Reduced taxation and increased military spending have driven levels of debt and interest owed to the Social Security Trust Fund to untenable levels. As depicted in Figure 6, the national debt has doubled since 2001. The first of the baby boomers born in 1946 are reaching 62 years of age and are beginning retirement in 2008, so the entitlement problem worsens daily. In the short term, economists estimate the Social

Security entitlement system can only remain solvent through either a 40% increase in payroll taxes or a 40% reduction in social security benefits. If we choose to push responsibility for fixing the problem to the next generation over a 75 year period, the insolvency of the trust fund can be corrected through a 14% increase of payroll taxes and a corresponding 12% reduction in benefits. Obviously, both scenarios would be universally rejected as unpopular and difficult to implement politically. As a result, the remaining financial choices are all simple but equally painful: reduce the size of paychecks, reduce the level of benefits received, increase income taxes, or some painful but acceptable mix of all three. Because reducing take-home pay and/or reducing benefits for those already in retirement are such contentious political issues, choosing either option would spell doom for our new president's hopes of serving an eight year term. The only acceptable solution is immediate reduction in government spending and increasing income taxes across the population to help pay for past, present and future wartime spending as well as associated interest debt on funds borrowed from entitlement programs.⁴³

This is no easy task. The cost of the War on Terror as of fiscal year 2008 is \$859 billion and counting. The amount borrowed from entitlement programs since 2001 to finance homeland defense programs, including the war, is \$1.7 trillion.⁴⁴

But what is the real impact? The following hypothetical scenario assumes balanced government spending with no cuts to current programs. The scenario uses current tax brackets, disregards continuously compounding interest, and does not take into account potential revenues from capital gains, estate taxes, and corporations. The scenario is simply intended to depict the massive tax burden to return the country to its

pre-war financial posture if individual taxpayers were required to fund what has already taken place.

Shared Cost of Military Operations - \$859 Billion				
Income Group	Number of Taxpayers	Percent Burden	Total	Cost Per Taxpayer
Top 1%	1,357,192	39.89%	\$342,655,100,000	\$252,473.56
Top 2 to 5%	5,428,766	20.25%	\$173,947,500,000	\$32,041.81
Top 6 to 10%	6,785,958	10.65%	\$91,483,500,000	\$13,481.29
Top 11 to 25%	20,357,874	15.47%	\$132,887,300,000	\$6,527.56
Top 26 to 50%	33,929,790	10.75%	\$92,342,500,000	\$2,721.58
Bottom 50%	67,859,580	2.99%	\$25,684,100,000	\$378.49
Shared Cost of Entitlement Payback - \$1.7 Trillion				
Top 1%	1,357,192	39.89%	\$677,520,573,693	\$499,207.61
Top 2 to 5%	5,428,766	20.25%	\$343,940,627,157	\$63,355.21
Top 6 to 10%	6,785,958	10.65%	\$180,887,292,801	\$26,656.12
Top 11-25%	20,357,874	15.47%	\$262,753,654,425	\$12,906.73
Top 26-50%	33,929,790	10.75%	\$182,585,765,034	\$5,381.28
Bottom 50%	67,859,580	2.99%	\$50,784,319,763	\$748.37

Figure 8: Hypothetical Individual Tax Liability Scenario⁴⁵

Of course, this is not an actuary table, and taxpayer responsibility is shown as a snapshot and not spread over a significant period of time. Any likely tax scenario the government uses to recover revenue and reduce the wartime debt will occur over many years and will be tied to reductions in spending on existing programs to recover even more revenue. Although completely hypothetical, the table is a stark reminder of the expense of restructuring the government; mobilization and deployment to war; and of the eventual responsibility that must be assumed for resourcing the conflict.

The severity may be tempered over time, but changes to tax law and corresponding tax increases are coming. The sudden and painful burden of financial responsibility placed on the American people, coupled with already difficult financial times and the comfort and complacency provided by seven safe years since being attacked will cause a dramatic change in attitudes regarding the need for war. In short, the national will to keep fighting war will be inversely proportional to the amount of

financial liability the people must endure for its prosecution. Only dramatic reductions in spending can offset the negative effect of unavoidable tax increases, thus prolonging the will of the people and prolonging the war itself until acceptable conditions for victory are achieved. In the past, the American people stopped supporting military operations as a function of intolerance to the number of casualties sustained. With the public's detached involvement with the current conflict and its relative tolerance of casualties when compared to past wars, it will soon be determined the fastest path to adversely affect national will be through the war's direct impact on personal wealth.

Effect on the Economy as an Element of National Power. The eventual effect of overreaction to the 9/11 attacks on the American people will be significant, but can be tempered with across-the-board restraint. The eventual effect of the overreaction on the U.S position as an economic superpower is potentially much more dramatic. Even before the recent crisis in American financial markets, surveys taken in March and April 2008 found that many countries felt U.S. markets were already having a negative impact on their own economies. As a result, those countries surveyed gave their own economies increasingly negative ratings. With America increasingly blamed for poor worldwide economic outlooks, a quick recovery from the counter-intuitive financial decisions made when the country was mobilizing for war is imperative.⁴⁶

In recent weeks, many countries have had tangible reasons to deplore America's economic influence. Majorities in 21 of 23 countries surveyed outside of the U.S. said that what happens in the American economy affects economic conditions in their own country. More than 80% took this view in nine countries: Japan, South Korea, Australia, Britain, Germany, Egypt, Lebanon, Jordan and France.⁴⁷

In regions throughout the world, people who believe the American economy influences their own economy tend to say it is a negative rather than a positive influence. Majorities in 14 of the 23 countries surveyed considered the American economic influence to be negative. Seventy percent or more of those polled expressed this view in Britain (72%), Germany (72%), Australia (71%), Turkey (70%) and France (70%). Remarkably, these are American allies with these negative attitudes, who until now have long been the proud recipients of American economic influence.⁴⁸

American stances on foreign policy have been controversial to many since 9/11, but America's leadership in the recent world economic downturn may cause additional challenges when the country attempts to exert its economic influence overseas in the future. Even before the recent collapse of U.S. markets, half of those countries surveyed felt U.S. economic policy led to an ever-widening gap between wealthy and poor nations.⁴⁹

Economic losses aside, the nation has lost credibility abroad. In the 2006 edition of the *National Security Strategy of the United States*, "reforming financial systems to ensure stability and growth" was stated as an economic imperative. Additionally, the United States pledged to "monitor financial systems to prevent crises before they occur." Finally, the strategy states that the United States will "work with public and private partners to help secure the international financial system against abuse by criminals, terrorists, money launderers, and corrupt political leaders...and protect the system from tainted capital."⁵⁰ Many in the United States and overseas would agree the government failed to keep those promises and a diminished economic position overseas is the unfortunate result.

Recommendations and Conclusion

America's will is not shaken, and America is still an economic force to be reckoned with—for now. However, immediate steps must be taken to ensure both those proclamations remain unchanged. With success beginning to emerge in Iraq and Al-Qaeda's leadership in hiding in Pakistan, America cannot squander the sacrifices it has already made. First, our leadership should define clear conditions for victory. Second, the government must look for efficiencies within the homeland defense establishment and curb costs where possible. Third, the government should look past the current fight overseas and begin developing "non-kinetic" ways to continue engagement of the enemy long after troops are redeployed to the United States. Finally, the government must responsibly address its overreaction to the 9/11 attacks and begin a measured fiscal recovery. The government should be obligated to put the country back on a pre-war financial footing in order to reduce long-term individual impact on quality of life and entitlement systems, and to reduce long-term collective impact on the nation's ability to use its economy as an element of national power.

The end state for the war must be established without delay. Conditions that define victory must be tangible, attainable, and unambiguous. Defining who the enemy actually is remains difficult, but doing so will allow some predictability in terms of the war's remaining duration and scope. Most importantly, clear definition of victory will allow better visibility of required funding and additional resources in the future.

The homeland security establishment must receive a top-to-bottom study of its efficiency. The mere fact that the government admits DHS has squandered over \$34 billion of its funding since inception is enough justification to warrant this proposed study. A look at the vast number of events DHS is trying to prevent is also warranted,

and should be studied in terms of their probability of actually occurring. Because of DHS' demonstrated inefficiency it is apparent that attempting to protect everything is to effectively protect nothing. Likewise, to guard against every possible contingency is to effectively guard against nothing. A perfect illustration of this is the number of shipping containers that enter the nation's ports each day from all over the world. A mere 1% of these containers are randomly checked for threats, leaving the other 99% to enter some of the nation's largest cities and leave on trucks for transit elsewhere inside our borders. Furthermore, instead of massive expenditures to "protect" 73 metropolitan areas and the 80,000 soft targets referenced earlier in this paper, it would be more rational to focus on the nation's ability to detect nuclear weapons, protect its power grid, and prepare coherent, efficient responses to terrorist acts.⁵¹ Author Howard Kunreuther proposes two simple questions regarding measured responses to terrorism:

- How much should we be willing to pay for a small reduction in probabilities that are already extremely low?
- How much should we be willing to pay for actions that are primarily reassuring but do little to change the actual risk?⁵²

These are simple questions, but had the government asked them seven years ago the approach to the homeland security establishment may have been completely different. More importantly, the answers from these same questions could be effectively used to temper future operations and corresponding expenditures.

After the current military operations in Iraq and Afghanistan are complete, the military should remain engaged overseas, but should also be working to get troops back to their bases in the United States as soon as possible. The "Korea Option" and the two

other options on the table for the remainder of the war in Iraq should be carefully examined and funded appropriately—without deficit spending. The decision to implement any long-term option in Iraq should be made with the country's ability to raise funds for its execution as its primary concern. As savings are gained from reduced military operations abroad, resistance to a wholesale "peace dividend" should be exorcised and funding for heightened signals intelligence and for tracking of terrorist finance networks should be explored for use of that savings. As U.S. officials have learned from numerous successful operations in Afghanistan and Iraq, tracking communications with ground and space-based sensors and tracking money passing between accounts leads to targetable intelligence and prevention of terrorist attacks. The remainder of the savings should immediately be applied to the national debt. Finally, policies should be formalized that will allow the U.S. military to be more effective in defense of the homeland and to prevent unnecessary spending because of duplicated capability or effort. For example, Federal Aviation Administration radars are ineffective at tracking aircraft flying under 3000 feet, and make the country extremely vulnerable to attack from general aviation and remotely piloted aircraft. This gap should immediately be closed and become the responsibility of the Pentagon, which already has a very capable air defense capability.⁵³

Finally, the nation's continued solvency must be addressed. The American people must learn to be as conversant on the national debt as they are about their favorite sports teams. They must collectively understand that the debt is now over \$10 trillion dollars, and has doubled since America declared war against terrorism. They should know that the \$10 trillion debt is split almost equally between "debt held by the

public” in the form of savings bonds etc., and “intergovernmental holdings” which is a euphemism for the government borrowing wartime funds from their retirement accounts. Lastly, they should be educated on the mutual sacrifice, commensurate with their individual income level, which must occur to return the country to economic prominence, to pay for the security and safety they have enjoyed over the last seven years, and to reimburse their Social Security and Medicare Trust Funds.

As Osama Bin Laden stated in 2004 after watching three years of American overreaction to the 9/11 attacks, he intended to keep the nation engaged with just enough Al Qaeda effort to cause bankruptcy. This approach worked with the Soviet Union in the 1980s, and although he had no idea how America would react to the attacks of 9/11, he quickly assessed that this tactic would work against the United States as well. The nation simply cannot allow his prophesy to come true, and must begin immediate work to moderate its collective approach to the war. If a long war is to be sustained, mutual sacrifice and every possible efficiency must be explored and exploited. Victory achieved through bankruptcy would be hollow indeed.

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